amounts so treated are considered derived proportionately from each such item of tax preference.

[T.D. 7564, 43 FR 40484, Sept. 12, 1978, as amended by T.D. 8138, 52 FR 15309, Apr. 28, 1987]

§ 1.58–8 Capital gains and stock options.

(a) *In general.* Section 58(g)(2) provides that the items of tax preference specified in section 57(a)(6), and § 1.57–1(b) (stock options), and section 57(a)(9), and § 1.57–1(i) (capital gains), which are attributable to sources within any foreign country or possession of the United States shall not be taken into account as items of tax preference if, under the tax laws of such country or possession, preferential treatment is not accorded:

(1) In the case of stock options, to the gain, profit, or other income realized from the transfer of shares of stock pursuant to the exercise of an option which is under United States tax law a qualified or restricted stock option (under section 422 or section 424); and

(2) In the case of capital gains, to gain from the sale or exchange of capital assets (or property treated as capital assets under United States tax law).

Where capital gains are not accorded preferential treatment within a foreign country, capital losses as well as capital gains from such country are not taken into account for purposes of the minimum tax.

(b) *Source of capital gains and stock options.* Generally, in determining whether the capital gain or stock option item of tax preference is attributable to sources within any foreign country or possession of the United States, the principles of sections 861–863 and the regulations thereunder are applied. Thus, the stock option item of tax preference, representing compensation for personal services, is attributable, in accordance with § 1.861–4, to sources within the country in which the personal services were performed. Where the capital gain item of tax preference represents gain from the purchase and sale of personal property, such gain is attributable, in accordance with § 1.861–7, entirely to sources within the country in which the property is sold. In accordance with paragraph (c) of § 1.861–7, in any case in which the sales transaction is arranged in a particular manner for the primary purpose of tax avoidance, all factors of the transaction, such as negotiations, the execution of the agreement, the location of the property, and the place of payment, will be considered, and the sale will be treated as having been consummated at the place where the substance of the sale occurred.

(c) *Preferential treatment.* For purposes of this section, gain, profit, or other income is accorded preferential treatment by a foreign country or possession of the United States if (1) recognition of the income, for foreign tax purposes, is deferred beyond the taxpayer's taxable year or comparable period for foreign tax purposes which coincides with the taxpayer's U.S. taxable year in cases where other items of profit, gain, or other income may not be deferred; (2) it is subject to tax at a lower effective rate (including no rate of tax) than other items of profit, gain, or other income, by means of a special rate of tax, artifical deductions, exemptions, exclusions, or similar reductions in the amount subject to tax; (3) it is subject to no significant amount of tax; or (4) the laws of the foreign country or possession by any other method provide tax treatment for such profit, gain, or other income more beneficial than the tax treatment otherwise accorded income by such country or possession. For the purpose of the preceding sentence, gain, profit, or other income is subject to no significant amount of tax if the amount of taxes imposed by the foreign country or possession of the United States is equal to less than 2.5 percent of the gross amount of such income.

(d) *Examples.* The principles of this section may be illustrated by the following examples:

Example 1. The Bahamas imposes no income tax on individuals or corporations, whether resident or nonresident. Since capital gains are subject to no tax in the Bahamas, capital gains are considered to be accorded preferential treatment and will be taken into account for purposes of the minimum tax.

Example 2. In France, except in certain cases involving the sale of large blocks of stock, a nonresident individual is not subject to tax on isolated capital gains transactions. Since such capital gains are not subject to tax in France, they are considered to be accorded preferential treatment irrespective of the treatment accorded other capital gains in France and such gains will be taken into account for purposes of the minimum tax.

Example 3. In Germany, in the case of the sale within 1 taxable year of 1 percent or more of the shares of a corporation in which an individual taxpayer is regarded as holding a substanital interest, the gains on the sale of the large block of stock will be taxed as extraordinary income at one-half the ordinary income tax rate. Since these gains are taxed as a reduced rate of tax in comparison to other income, they are considered to be accorded preferential treatment and will be taken into account for purposes of the minimum tax.

Example 4. In Belgium, gains derived by an individual in the course of regular speculative transactions are taxed as ordinary income, but with an upper limit of 30 percent. Rates of tax on individuals in Belgium range from approximately 30 percent to approximately 60 percent. Since the gains on speculative transactions are taxed at a maximum rate which is more beneficial then the rates accorded to other income, such gains are considered to be accorded preferential treatment and will be taken into account for purposes of the minimum tax.

Example 5. In France, gains derived by a company on the sale of fixed assets held for less than 2 years are treated as short-term gains. The excess of short-term gains in any fiscal year is taxed at the full company tax rate of 50 percent. However, this tax may be paid in equal portions over the 5 years immediately following the realization of such short-term gains. Since recognition of the short-term gains for tax purposes is subject to deferral over a 5-year period, such gains are considered to be accorded preferential treatment and will be taken into account for purposes of the minimum tax.

Example 6. Also in France, in the case of the sale or exchange by a company of depreciable assets and nondepreciable asset owned for at least 2 years, the excess of long-term capital gains over long-term capital losses in a fiscal year is subject to an immediate tax at the reduced rate of 10 percent. Such excess, reduced by the 10-percent tax, is carried in a special reserve account on the taxpayer's books. If the excess is reinvested in other fixed asset within a stated period, no further tax is due. If the amounts in the special reserve are distributed, they will be treated as ordinary income for the fiscal year in which the distribution is made. Since such gains (other than those distributed in the same fiscal year they are realized) are subject to deferral or a reduced rate of tax, they are (except to the extent distributed in the year of realization) considered to be accorded preferential treatment and are taken into account for purposes of the minimum tax.

Example 7. In Sweden, in the case of gains derived by an individual on the sale of shares or bonds held for 5 years or less, 25 percent of the gains are taxed if the holding period is 4 to 5 years, 50 percent of the gain is taxed if the holding period is 3 to 4 years, and 75 percent of the gain is taxed if the holding period is 2 to 3 years. The gain is fully taxable at ordinary income rates if held for less than 2 years. Thus, gains on shares or bonds held for 2 years or more are considered accorded preferential treatment in Sweden since they are either subject to exemption or treatment comparable to the U.S. capital gains deduction and are taxed at a reduced rate. Thus, such gains are taken into account for purposes of the minimum tax.

Example 8. Pursuant to Article XIV of the United States-United Kingdom Income Tax Convention, a resident of the United States is exempt from United Kingdom tax on most capital gains. Since such capital gains are exempt from United Kingdom taxation, they are considered to be accorded preferential treatment and are taken into account for purposes of the minimum tax.

Example 9. An individual resident of the United States, is desirous of selling his stock in a corporation listed on the New York Stock Exchange. He requests the stock certificates from his broker in the United States, travels to a foreign country, delivers the certificates to a broker in that country, and has the foreign broker execute the sale which takes place on the New York Stock Exchange. Since the sale was consummated in the United States, pursuant to paragraph (b) of this section and §1.861–7, the resulting capital gain item of tax preference is attributable to sources within the United States.

Example 10. Two individuals, both residing in the United States, negotiate and reach agreement in New York City for the sale of stock of a closed corporation. Prior to the transfer of the stock, in order to avoid imposition of the minimum tax, both individuals travel to a foreign country which does not accord preferential treatment to capital gains, but imposes a 5-percent rate of income tax which would be fully creditable against U.S. tax under sections 901 and 904 if the capital gains were sourced in that country. The stock is actually transferred and consideration paid in the foreign country. Since the primary purpose of consummating the sale in the foreign country was the avoidance of tax, pursuant to paragraph (b) of this section, and §1.861–7(c), the resulting capital gain item of tax preference will be considered attributable to sources within the country in which the substance of sale took place or, in this case, the United States.

[T.D. 7564, 43 FR 40492, Sept. 12, 1978]

§ 1.58–9 Application of the tax benefit rule to the minimum tax for taxable years beginning prior to 1987.

(a) *In general.* For purposes of computing the minimum tax liability imposed under section 56 of the Internal Revenue Code of 1954 (Code), taxpayers are not liable for minimum tax on tax preference items that do not reduce the taxpayer's tax liability under subtitle A of the Code for the taxable year. In general, tax preference items that do not reduce tax liability under subtitle A for the taxable year are those from which no current tax benefit is derived because available credits would have reduced or eliminated the taxpayer's regular tax liability if the preference items had not been allowed in computing taxable income. However, any credits that, because of such preference items, are not needed for use against regular tax (''freed-up credits''), are required to be reduced under the rules of paragraph (c) of this section. For purposes of this section, a taxpayer's regular tax is the Federal income tax liability under subchapter A of chapter 1 of the Code, not including the minimum tax imposed by section 56. Unless otherwise noted, all references to Internal Revenue Code sections refer to the Internal Revenue Code of 1954.

(b) *Effective date.* The rules of this section are effective May 5, 1992, but only as they affect tax preference items that arise in taxable years beginning after December 31, 1976, and before January 1, 1987.

(c) *Adjustment of carryover credits*—(1) *In general.* A taxpayer's freed-up credits must be reduced by the additional minimum tax that would have been imposed if a current tax benefit had been derived from preference items that did not actually produce a current tax benefit. The amount of this reduction shall be calculated in the following manner—

(i) Determine the amount of freed-up credits;

(ii) Determine the amount of tax preference items (if any) from which a current tax benefit was derived for the taxable year (''beneficial preferences''), and the amount of preferences from which no current tax benefit was derived for the taxable year (''non-beneficial preferences''); and

(iii) Determine the portion of the total minimum tax on all tax preference items for the taxable year that is attributable to the non-beneficial preferences.

The freed-up credits are then reduced by an amount equal to such portion of the minimum tax.

(2) *Determine freed-up credits.* (i) To determine the freed-up credits for the taxable year, first determine the regular tax that would have been imposed for the taxable year if preference items had not been allowed in computing taxable income (''non-preference regular tax''). In the case of a taxpayer with the capital gain preference described in section 57(a)(9)(B), non-preference regular tax is computed without regard to section 1201 and without adding the section 57(a)(9)(B) preference amount to taxable income. Second, compute the amount of credits that would have been allowed to reduce the non-preference regular tax. The credits available to reduce non-preference regular tax shall include any freed-up credits from other taxable years, as reduced under paragraph (c)(5) of this section, that are carried to the current taxable year. Third, subtract the amount of credits that were actually allowed to reduce the regular tax for such taxable year from the amount of credits that would have been allowed to reduce non-preference regular tax. The result is the amount of the freed-up credits.

(ii) The following examples illustrate the determination of freed-up credits. The first two examples assume that the foreign tax credits being used do not exceed the limitation under section 904.

Example 1. In 1982 Corporation B has $17.6 million dollars in foreign tax credits available for the taxable year. If preference items were not allowed in determining regular tax, the regular tax would have been $10.2 million and foreign tax credits used to reduce regular tax would have been $10.2 million. Because of tax preference items, however, B's regular tax is $6.3 million and the amount of foreign tax credits actually used to reduce the regular tax is $6.3 million. The amount of